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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: November 19, 2009

Inflation Developments

1. Consumer prices surged by 2.41 percent in October, while inflation declined to 5.08 percent year-on-year. October price developments coincided with the outlook presented in the Summary of the September Monetary Policy Committee Meeting. While annual inflation decreased, monthly inflation picked up dramatically due to seasonal price hikes in food and clothing, renewed electricity tariffs and tax adjustments on durable goods.

2. The annual rate of increase in food prices fell to 5.82 percent in October. Lower exports of fruits and vegetables brought annual food inflation down, while soaring meat prices put upward pressure on food and catering prices.

3. Energy prices rose by 2.50 percent in October, of which the hikes in residential electricity tariffs accounted for 2.30 percentage points. Consequently, the rise in energy prices added about 0.35 percentage points to CPI inflation. Despite having edged up since May, energy prices still hover around the year-ago level.

4. Prices of durable goods were up 4.24 percent in October following the expiration of the temporary tax cuts. Adjusted for changes in taxes, the rate of increase in durable goods appears to remain subdued and stable.

5. Annual services inflation, which was on a continuous declining path in the last one year, displayed a modest increase in October. However, the assessment of the subcategories indicates that this development would not adversely affect the broader outlook. Although, seasonally adjusted monthly increase in services inflation is higher than the levels registered during the first quarter (when the effects of the economic slump on inflation was most significant), it remains well below the pre-crisis average.

6. Overall, adjusted for tax changes, core inflation measures suggest that underlying inflation continues to run at low levels.

Factors Affecting Inflation

7. In line with the Monetary Policy Committee's (the Committee) previous assessments, recent data releases indicate that the ongoing recovery in economic activity would be gradual and protracted. During the third quarter, average industrial production was slightly up from the second quarter, in seasonally adjusted terms. While October's capacity utilization data indicate that production continues to grow modestly, considerable slack remains. The Committee emphasized that the recovery in production is slow, and noted that the support of the fiscal measures to the production has been limited at this stage, and that underlying economic activity is still weak. Against this backdrop, the Committee reiterated that the current pace of economic recovery would not put upward pressure on inflation, as it implies low resource utilization for quite some time.

8. Consumption demand has displayed a weaker course, after having increased markedly during the second quarter. Production in non-durable goods, which was not targeted by the fiscal stimulus, continued to contract in September, also partly owing to the significant income effect. Accordingly, consumer goods production fell quarter-on-quarter in seasonally adjusted terms during the third quarter, while imports of consumer goods rose at a more moderate pace than in the second quarter. Production and imports data suggest that consumption demand was essentially flat in the third quarter. Moreover, following the expiration of the tax incentives in October, indicators point to further weakening in domestic demand. The lack of domestic demand continued to increase as a factor restraining capacity utilization during October in seasonally adjusted terms, and at the same time, consumption indices declined significantly month-on-month.

9. Domestic investment demand remains weak. Excluding transport vehicles, the production of capital goods flattened out during the third quarter in seasonally adjusted terms. A similar pattern was also observed in capital goods imports. Taken together, these indicators suggest that, despite a slight quarterly rebound in the third quarter, private machinery and equipment investments remain at low levels. The Committee restated that the current demand uncertainty and idle capacity might continue to have a dampening effect on investment.

10. Foreign demand remains weak. The export quantity index dropped by 11.8 percent year-on-year during the third quarter, but was up quarter-on-quarter in seasonally adjusted terms. October and November data indicate that exports continue to recover modestly.

11. Another factor restraining capacity utilization has been the weak demand in foreign markets. Although this adverse impact has been easing since June,

owing in particular to the improved outlook for euro area growth and new export market opportunities, it remains to be seen whether the recent improvement in the foreign demand outlook is sustainable. Committee members noted that the global economic recovery driven by fiscal and monetary expansion packages since the second quarter of 2009 might lose momentum with the gradual withdrawal of these measures. Thus, the Committee indicated that it would take quite a long time for foreign demand to return to pre-crisis levels.

12. Employment conditions are likely to take a long time to fully recover. In fact, having declined during the past two months in seasonally adjusted terms, non-farm unemployment rose again month-on-month during July-September period. Accordingly, non-farm unemployment climbed to 17 percent in the third quarter, which is 4.1 percentage points higher compared to the previous year. Applications for unemployment benefits remained at high levels in October, indicating that unemployment would remain elevated during the final quarter. In view of the current economic outlook, the Committee maintained the view that it would take a long time for the employment conditions to fully recover.

Monetary Policy and Risks

13. The Committee, in light of the assessments summarized above, reiterated that resource utilization, and thus inflation, would continue to hover around low levels. While headline annual inflation could display some upward movements through mid-2010 due to strong base effects, it was reemphasized that this possibility had already been reflected in the monetary stance outlined in the October Inflation Report. Accordingly, the Committee indicated that the monetary policy stance outlined in the Inflation Report has not changed.

14. The policy rate cuts implemented since November 2008, and the improvements in global risk perceptions have started to exert favorable effects on credit markets. Although the recent Banks' Loan Tendency Survey suggests that banks are still cautious in extending loans, there are signs of easing lending standards, especially in consumer loans. The Survey also reveals the expectation of a continued recovery in credit demand. However, the effectiveness of the credit channel in supporting economic activity has been somewhat restrained owing to the ongoing tightness in lending standards for small- and medium-sized enterprises and for longer-term loans.

15. Although recent data releases indicate that the worst is likely to be over, concerns regarding the strength of the global recovery remain. In particular, ongoing problems in credit and labor markets pose downside risks for global activity. Should global conditions deteriorate again, and consequently delay

the domestic recovery, another cycle of rate cuts would be considered. Given the lingering problems across the global economy and the ongoing uncertainty regarding the strength of the recovery, the Committee reiterated that it would be necessary for the monetary policy to maintain an easing bias for a long period of time. Moreover, the Committee emphasized that policy rates had been cut by 1025 basis points since November 2008, and thus, rather than focusing on the level of the policy rate in the current circumstances, it would be more important to keep rates at low levels for an extended period. Therefore, it was indicated that future rate decisions would be conditional on economic data and developments.

16. According to the Committee members, another possible scenario involves a surge in capital inflows to emerging markets owing to the relative improvement of credit risk across these countries. Ample liquidity driven by the expansionary fiscal and monetary policies on a worldwide scale, coupled with rising risk appetites, have led to large capital inflows to emerging markets. Current slack in the economy would imply that a fall in the cost of imported inputs could be rapidly transmitted to consumer prices, suggesting that a further acceleration in capital inflows may exacerbate downward risks on inflation. Realization of such a scenario could lead to temporarily lower policy rates.

17. The Central Bank of Turkey (CBT) will continue to monitor fiscal policy developments closely while formulating monetary policy. Enhancing the framework set out in the Medium Term Program (MTP) through further structural adjustments to strengthen fiscal discipline, would support the improvement of Turkey’s sovereign risk. Should the goals set out in the MTP be implemented, it would be possible to keep policy rates at single digits throughout the forecast horizon.

18. The course of oil and other commodity prices constitutes another important risk factor. Ample liquidity driven by countercyclical policies on a global scale has encouraged speculative investments not only into emerging market currencies, but also into commodities. Therefore, oil and other commodity price developments warrant careful surveillance, even under a scenario of a gradual global economic recovery. Nonetheless, weak domestic demand conditions would limit the pass-through stemming from upside cost-push shocks. Therefore, the Committee will not react to short-term commodity price volatility, especially when resource utilization remains at depressed levels. However, if an uptrend in commodity prices reflects a strong and durable rebound in global activity that would in turn create inflationary pressures, then monetary policy will react appropriately to keep inflation in line with the medium-term inflation targets.

19. The CBT has been taking the necessary measures to contain the adverse effects of the global financial turmoil on the domestic economy. However, prudent monetary policy is necessary, but not sufficient to maintain the resilience of the economy against the global crisis. Therefore, strengthening the commitment to fiscal discipline and the structural reform agenda is also critical for facilitating expectations management and thus for supporting the effectiveness of the monetary policy decisions. In this respect, timely implementation of the structural reforms envisaged by the Medium Term Program and European Union accession process remains to be of utmost importance.